TENNESSEE GENERAL ASSEMBLY
FISCAL REVIEW COMMITTEE

FISCAL NOTE

SB 502 – HB 1350

March 2, 2009

SUMMARY OF BILL: Requires combined reporting for franchise and excise tax purposes; reduces the state sales tax rate on food from 5.5 percent to 4.5 percent. Holds local government harmless from loss of state-shared sales tax as a result of reducing the state sales tax rate on food.

ESTIMATED FISCAL IMPACT:

Decrease State Revenue – Net Impact –
$35,934,300/FY09-10
$71,868,600/FY10-11 and Subsequent Years

Increase State Expenditures –
$6,098,000/FY09-10
$5,716,500/FY10-11 and Subsequent Years

Other Fiscal Impact - Beginning in FY10-11, there will be additional forgone state revenue due to the natural growth of taxable food sales. As taxable food sales grow each year, forgone state sales tax revenue will increase. Assuming taxable food sales grow by 4.5 percent from FY09-10 to FY10-11, total forgone state sales tax revenue for FY10-11 would be approximately $4,134,100. Forgone state revenue will increase each successive year by the rate at which taxable food sales grow in the future.

Assumptions applied to sales tax on food:

- "Food and food ingredients" means substances, whether in liquid, concentrated, solid, frozen, dried, or dehydrated form, that are sold for ingestion or chewing by humans and are consumed for their taste or nutritional value.
- "Food and food ingredients" does not include alcoholic beverages, tobacco, candy, dietary supplements, or prepared food.

- According to the Department of Revenue, state sales tax revenue collected from the sale of food and food ingredients in Tennessee for FY07-08 was approximately $504,600,000.
- Food and food ingredients were taxed at two different rates during FY07-08. The tax rate from July 1, 2007 through December 31, 2007 was six percent. On January 1, 2008 the tax rate changed to 5.5 percent as a result of Public Chapter 600 from the 2007 Public Acts. Therefore, the average tax rate for FY07-08 was 5.75 percent.
- The average tax rate calculated for FY07-08 (5.75 percent) is used to estimate total taxable food sales for FY07-08.
- Total taxable food sales for FY07-08 are estimated to be $8,775,652,200 ($504,600,000 / 5.75% = $8,775,652,174).
- Based on recent one-year price increases as measured by the Consumer Price Index for Food (Source: U.S. Department of Labor: Bureau of Labor Statistics), food prices are estimated to increase by at least 4.5 percent in each of the next two years.
- Taxable food sales are estimated to increase by an additional 0.5 percent in FY09-10 due to the elasticity factor resulting from the one percent tax rate reduction as proposed.
- Taxable sales for FY09-10 (adjusted for two years of growth) are estimated to be $9,629,084,400 (($8,775,652,200 x 104.5%) x 105.0% = $9,629,084,376).
- The decrease of state sales tax revenue is estimated to be $96,290,800 ($9,629,084,400 x 1.0% = $96,290,844) in FY09-10.
- The estimated $96,290,800 in state sales tax revenue would be apportioned as follows in FY09-10: $27,948,000 to the General Fund, $62,682,400 to the Education Fund, $4,422,200 to local governments, $353,800 to the Department of Revenue, and $884,400 to the Sinking Fund.
- The net decrease to state revenue for FY09-10 is estimated to be $91,868,600 ($96,290,800 - $4,422,200 local share = $91,868,600).
- Local governments will be held harmless from the loss of state-shared sales tax under this bill. Therefore, an increase to recurring state expenditures of $4,222,200 per year.
- The will be additional and increasing amounts of foregone sales tax revenue in subsequent years due to the natural growth of taxable food sales.

Assumptions applied to combined reporting:

- The fiscal impact of combined reporting for franchise and excise tax is dependent upon multiple unknown factors.
- According to DOR, research on similar estimates from other states that have enacted or contemplated enacting combined reporting shows the potential for an increase of tax revenue between 10 and 20 percent.

- DOR suggests that the impact in Tennessee could be much less than amounts estimated for other states due to the fact that financial institutions are currently required to file combined returns and taxpayers also have the current option for franchise tax to elect to report their net worth on a consolidated basis. The department suggests any positive impact would certainly be mitigated by these factors.
- Based on information provided by DOR, and the impact of combined reporting being dependent upon factors mentioned above and other multiple unknown factors, a specific estimate cannot be quantified. However, the increase to state revenue resulting from combined reporting is reasonably estimated to exceed $20,000,000 per year.
- According to DOR, significant additional resources will be required to implement the provisions of this bill (two Tax Audit Supervisor positions; three Tax Auditor 4 positions; three Tax Auditor 3 positions; three Tax Auditor 2 positions; three Revenue Audit Technicians; one Tax Audit Supervisor Special position; and six Tax Auditor 2 positions). The increase to recurring state expenditures for these 21 positions is estimated to be $1,494,300 ($878,200 salaries, $438,800 benefits, $177,300 other). One-time state expenditures related to creating these additional positions is estimated to be $130,500 (computers, software, equipment, communications, etc.).
- One-time state expenditure for computer enhancements and software modifications estimated to be $251,000.
- The first-year impact is estimated at 50 percent of the first full-year impact due to the January 1, 2010 enactment date.

CERTIFICATION:

This is to duly certify that the information contained herein is true and correct to the best of my knowledge.

James W. White, Executive Director

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